TENNESSEE DEPARTMENT OF REVENUE
LETTER RULING #96-16

WARNING

Letter rulings are binding on the Department only with respect to the individual taxpayer being addressed in the ruling. This presentation of the ruling in a redacted form is informational only. Rulings are made in response to particular facts presented and are not intended necessarily as statements of Department policy.

SUBJECT

Whether [COMPANY 1] and/or [COMPANY 2] are subject to Tennessee corporate franchise, excise taxes and Tennessee sales and use taxes.

SCOPE

This letter ruling is an interpretation and application of the tax law as it relates to a specific set of existing facts furnished to the Department by the taxpayer. The rulings herein are binding upon the Department, and are applicable only to the individual taxpayer being addressed.

This letter ruling may be revoked or modified by the Commissioner at any time. Such revocation or modification shall be effective retroactively unless the following conditions are met, in which case the revocation shall be prospective only:

(A) The taxpayer must not have misstated or omitted material facts involved in the transaction;
(B) Facts that develop later must not be materially different from the facts upon which the ruling was based;
(C) The applicable law must not have been changed or amended;
(D) The ruling must have been issued originally with respect to a prospective or proposed transaction; and
(E) The taxpayer directly involved must have acted in good faith in relying upon the ruling and a retroactive revocation of the ruling must inure to his detriment.

FACTS

[COMPANY 1], FEIN [NUMBER], is a holding company whose only business is to hold a 96.5% stock interest in [COMPANY 2], FEIN [NUMBER]. [COMPANY 2] is a manufacturer of [TYPE] machinery used in the [BUSINESS] industry. All [COMPANY

2's] manufacturing operations are in [STATE A - NOT TENNESSEE]. Both corporations are chartered in foreign states and neither has obtained a Tennessee Certificate of Authority. [COMPANY 1] has no Tennessee property, payroll or sales and [COMPANY 2] has no Tennessee property or payroll. Neither corporation has an office or employees in Tennessee. It is stated that through the tax year 1992 [COMPANY 2] filed Tennessee corporate franchise, excise tax returns under its own name. In 1993 [COMPANY 2] was acquired by [COMPANY 1] and began filing its franchise, excise tax returns under the name [COMPANY 1]. Returns filed under the name [COMPANY 1] showed only the operations of [COMPANY 2]. [COMPANY 2] filed Tennessee sales and use tax returns under its own name.

Approximately 10% of [COMPANY 2's] machinery is sold by [LESS THAN 10] independent dealers who also sell machinery of other manufacturers, including [COMPANY 2's] competitors. The nearest dealer to Tennessee is in [STATE B - NOT TENNESSEE]. Dealers purchase machinery directly from [COMPANY 2] and, when a dealer makes a sale to a customer, the customer pays the dealer directly. In some cases, a dealer may ask [COMPANY 2] to drop ship machinery sold to the dealer's customer.

[COMPANY 2's] independent dealers also participate in annual 3 day industry trade shows held in various states. The machinery displayed at trade shows belongs to the dealers. However, [COMPANY 2] will sometimes send one of their employees to a trade show to answer questions and promote their products. The [COMPANY 2] employee may solicit and take orders which are sent back to the [CITY IN STATE A - NOT TENNESSEE] plant for credit check and approval. The machinery is then shipped by common carrier to the customer. [COMPANY 2] does not recall a trade show displaying its products ever being held in Tennessee.

The remaining approximately 90% of [COMPANY 2's] sales are made directly from their plant in [STATE A - NOT TENNESSEE]. If someone in Tennessee were to be interested in purchasing a [COMPANY 2] product, he would call, write or fax the [COMPANY 2] plant. Someone there would talk to him by telephone about the product and perhaps fax or mail him product information. If he decided to buy the machinery, a credit check would be done and the product would be shipped by common carrier to the customer's address in Tennessee. [COMPANY 2] states that, for the tax years 1992, 1993, and 1994, it had sales of this type to Tennessee customers of [LESS THAN $1,000], [LESS THAN $2,500], and [LESS THAN $10,000] respectively as compared with total sales everywhere of [OVER $2,000,000], [OVER $2,500,000] and [NEARLY $3,000,000] respectively.

[COMPANY 2] will ship warranted replacement machinery parts to customers in various states, but does not do warranty or repair work. Customers who need installation of warranted parts, or who need repair work done on machinery manufactured by [COMPANY 2], must have such work done by local parties and pay for it themselves.

[COMPANY 2] will also test the operation of their [TYPE] machinery on [BUSINESS] samples which are mailed by customers or potential customers to its laboratory in [STATE A - NOT TENNESSEE]. [COMPANY 2] will report the test results to the sample owner, but makes no charge for either the test or the report.

ISSUES

1. Is [COMPANY 1] subject to Tennessee corporate franchise, excise taxes?

2. Is [COMPANY 1] subject to Tennessee sales and use taxes?

3. Is [COMPANY 2] subject to Tennessee corporate franchise, excise taxes?

4. Is [COMPANY 2] subject to Tennessee sales and use taxes?

RULINGS

1. No.

2. No.

3. No.

4. No.

ANALYSIS

1. [COMPANY 1] Has No Tennessee Franchise, Excise Tax Nexus

[COMPANY 1] is a foreign corporation with no Tennessee Certificate of Authority, no Tennessee property, payroll or sales, and no Tennessee office or employees. It has only a very remote connection with Tennessee. It holds stock in [COMPANY 2], a corporation which has customers in Tennessee but which, as is discussed below, is not doing business in Tennessee for purposes of Tennessee corporate franchise, excise tax nexus.

T.C.A. §§ 67-4-903(a) and 67-4-806(a) impose Tennessee franchise, excise taxes on corporations ". . . doing business in Tennessee . . .". It is axiomatic that stock ownership in a corporation which is not doing business in Tennessee does not, in and of itself, constitute doing business in Tennessee within the meaning of our franchise, excise tax statutes.

2. [COMPANY 1] Is Not Subject To Tennessee Sales and Use Tax

[COMPANY 1] has no sales to Tennessee customers. A corporation without Tennessee sales can not be subject to Tennessee sales and use taxes. Mere ownership of stock in [COMPANY 2], a corporation which does have Tennessee sales but, as is discussed below, is not subject to Tennessee sales and use tax, does not, in and of itself, subject [COMPANY 1] to Tennessee sales and use taxes.

3. [COMPANY 2] Is Not Subject To Tennessee Franchise, Excise Taxes

Tennessee corporate franchise, excise taxes are imposed on corporations for the privilege of doing business in Tennessee in corporate form. *First American National Bank v. Olsen*, 751 S.W.2d 417 at 421 (Tenn. 1987). The Tennessee Legislature clearly intends the franchise tax and the excise tax to be taken in tandem and construed together as one scheme of taxation. *Id.* Tennessee's jurisdiction to impose its franchise, excise taxes is governed by the Due Process Clause and the Commerce Clause of the United States Constitution as interpreted by the U.S. Supreme Court. These two Constitutional requirements pose distinct limits on the taxing powers of states. *Quill Corp. v. North Dakota*, 112 S.Ct. 1904 at 1909 (1992). In addition, Title 15 U.S.C.A. §§ 381-384, better known as Public Law 86-272, limits Tennessee's ability to impose a tax based on income upon corporations engaged in the manufacture and sale of tangible goods when their Tennessee business activities do not go beyond the solicitation of sales by employees or independent contractors for out-of-state acceptance and shipment.

[COMPANY 2] is engaged in the manufacture and sale of tangible goods. It has no property of either a tangible or intangible nature located in Tennessee. The corporation does not maintain a Tennessee office and it has no payroll or employees in Tennessee. It sells its products to dealers, none of which are located in Tennessee, and directly to its own customers in Tennessee. Sales to dealers are paid for by the dealer. When requested by a dealer to do so, [COMPANY 2] will ship its products to a dealer's customers in Tennessee. No sales are solicited in Tennessee. [COMPANY 2's] employees in [STATE A - NOT TENNESSEE] use the telephone, the U.S. mail and fax machines to solicit orders from Tennessee customers. Delivery of merchandise to Tennessee customers is made by common carrier from points outside Tennessee. Although [COMPANY 2] does ship replacement parts into Tennessee, it does not do warranty or repair work in Tennessee. All testing of machinery on customer's samples is done outside Tennessee.

[COMPANY 2] does not hold trade shows in Tennessee and does not recall ever sending an employee into Tennessee to participate in a trade show held by one of its dealers. However, [COMPANY 2] states that when it does send an employee to a dealer's annual three day trade show, the employee only answers questions, promotes the product, and solicits orders which are sent to [STATE A - NOT TENNESSEE] for credit check, approval and shipment.

The facts presented show that [COMPANY 2] has no activities in Tennessee and no tangible or intangible property here. Its Tennessee sales are made strictly through interstate commerce. A tax on the "privilege" of doing business is unconstitutional if applied against what is exclusively interstate commerce. *Complete Auto Transit, Inc. v. Brady*, 97 S.Ct. 1076 at 1081 (1977). In addition, [COMPANY 2's] Tennessee activities do not even rise to the level of solicitation of sales in interstate commerce. Even if [COMPANY 2] did send an employee into Tennessee to solicit sales for out-of-state acceptance and shipment, such an activity is protected from state taxation by Public Law 86-272. Tennessee can impose its corporate franchise, excise taxes on [COMPANY 2]

only if its Tennessee activities go beyond the solicitation of sales in interstate commerce. See *Wisconsin Department of Revenue v. William Wrigley, Jr.*, 112 S.Ct. 2447 (1992).

Under the facts given, none of [COMPANY 2's] activities subject it to Tennessee franchise, excise taxes.

4. [COMPANY 2] Is Not Subject To Tennessee Sales And Use Taxes

In *Quill Corporation v. North Dakota*, 112 S.Ct. 1904 (1992), the United States Supreme Court upheld the bright-line physical presence test requirement for imposition of sales and use taxes set forth in *National Bellas Hess, Inc. v. Department of Revenue*, 87 S.Ct. 1389 (1967). [COMPANY 2's] only contact with Tennessee is through common carriers, telephone, U.S. mail and fax machines. It has no physical presence in Tennessee at any time. Thus, Tennessee can not impose its sales and use taxes on [COMPANY 2].

If [COMPANY 2] were to send employees into Tennessee to solicit sales at industry trade shows held by dealers, the Tennessee sales and use taxes would be applicable.

Arnold B. Clapp, Tax Counsel

APPROVED: Ruth E. Johnson, Commissioner

DATE: 4/19/96